

VZCZCXRO4224
RR RUEHDT RUEHPB RUEHPT
DE RUEHBY #0615/01 1822153
ZNR UUUUU ZZH
R 012153Z JUL 09 ZDK
FM AMEMBASSY CANBERRA
TO RUEHC/SECSTATE WASHDC 1711
INFO RUEHDT/AMEMBASSY DILI 0199
RUEHJA/AMEMBASSY JAKARTA 5473
RUEHPB/AMEMBASSY PORT MORESBY 2017
RUEHKO/AMEMBASSY TOKYO 3593
RUEHBN/AMCONSUL MELBOURNE 6476
RUEHPT/AMCONSUL PERTH 4739
RUEHDN/AMCONSUL SYDNEY 4708

UNCLAS SECTION 01 OF 02 CANBERRA 000615

SENSITIVE
SIPDIS

DEPARTMENT FOR EAP/ANP, EEB

E.O. 12958: N/A

TAGS: [EAID](#) [ECON](#) [EFIN](#) [PREL](#) [PP](#) [AS](#)

SUBJECT: AUSTRALIAN CONFERENCE ON PAPUA NEW GUINEA

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¶1. (U) SUMMARY: Australian Papua New Guinea watchers are cautiously optimistic about the PNG economy but concerned about the longer term management of potential revenue windfalls from major resource projects, particularly the ExxonMobil LNG project that could double GDP by 2014. However, Australian economists warn that PNG Government forecasts are too optimistic and worry that PNG is looking to spend the windfall profits before the project is up and running. PNG officials in Australia are trying to convince observers that the country has learned from previous mistakes and is prepared to deal with the windfall profits. Australia provided over A\$400 million (US\$320 million) in assistance to PNG in 2008-09 and is the largest source of foreign investment. Experts in Canberra believe that PNG's overall economic development strategy is good, with implementation being the major challenge. Australian observers are optimistic that PNG's debt reduction and current account surplus in 2008 will allow them to weather the global financial crisis, though they worry about falling tax revenue caused by slowing global commodity demand. End Summary.

ASSESSMENT ON PNG,s FISCAL POLICY

¶2. (U) Australia National University held its annual PNG Policy Forum, considered the premier annual conference for Australia's comparatively large community of PNG watchers. Bob Warner, Director of the Center for International Economics, stated that PNG had a good strategy for dealing with the windfall profits from a new ExxonMobil LNG project in PNG,s Southern Highlands. At the same time, Warner admitted the government had a history of "patchy implementation" of previous similar strategies and that there is reason to be concerned about future governments following this strategy. He warned that the PNG government is already looking at ways to spend the significant expected profits from the LNG project but that there will be no cash flow until 2014. According to Warner, the PNG government is not sticking to their strategy to use 40% of windfall revenues from current projects to reduce debt, with only 17% of current revenues going to service debt. There is no accounting for 60% of the trust account spending and government also issued a supplementary budget after running a deficit in 2008 reversing the planned 1% surplus.

¶3. (U) The PNG High Commissioner to Australia countered that the government is anticipating strong profits and is preparing to use them properly. He suggested that a budget stabilization fund could easily be created. However, PNG saw its Mineral Resource Stabilization Fund emptied in 1999 to

deal with government debt instead of vital infrastructure. Economists at the conference expressed concern about a repeat caused by insufficient planning. Australia National University,s Aaron Battan also noted that the government's forecasted doubling of GDP from the LNG project was too optimistic.

OUTLOOK ON PNG

14. (U) The panel pointed out that PNG,s economy is primarily commodity-based and focused on cash crops (coffee, cocoa and palm oil), minerals, timber and petroleum. Gold, coffee and cocoa prices have remained stable, but the fall of oil and copper prices and the fall of timber demand are expected to reduce tax revenue 25% in 2009. However, AusAID Chief Economist Mark McGillivray stated that PNG was QChief Economist Mark McGillivray stated that PNG was relatively well positioned going into the GFC. PNG,s current account surplus was 8.7% of GDP in 2008 and the government reduced debt from 70% to 30% of GDP. PNG,s banking sector has remained stable and the country has limited exposure to the decline in tourism. 75% of the population depends on the subsistence sector which is more exposed to natural disasters. However, it was noted that PNG is highly exposed to fluctuations in commodity prices and overseas demand. Government expenditures and inflation have also increased substantially with the windfall revenues from the recent commodity price boom.

15. (SBU) COMMENT: As Australia,s former protectorate and closest neighbor, PNG remains a major interest to Australian academics and government officials. Australian experts are clearly wary about PNG plans to absorb what could be substantial profits from the ExxonMobil LNG play. Australia,s mixed record with commodities extraction in PNG

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may play a role in that, but concerns over institutional capacity and transparency are clearly coloring their views on how PNG should and will handle the revenue. PNG is Australia,s largest recipient of development assistance, and wasteful spending of windfall profits could undermine further support in Canberra for future increases in assistance. End Comment.

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